

Chair  
CABINET ECONOMIC GROWTH AND INFRASTRUCTURE COMMITTEE

## **REVIEW OF THE OVERSEAS INVESTMENT ACT: REPORT BACK ON FINAL DRAFTING OF REGULATORY CHANGES AND MINISTERIAL DIRECTIVE LETTER**

### **Proposal**

1. This paper asks Cabinet to note final drafting changes to the Overseas Investment Regulations 2005 and final amendments to the Ministerial Directive Letter to the Overseas Investment Office. The changes put into effect Cabinet decisions to conclude the review of the Overseas Investment Act [EGI Min (10) 23/1 refers].
2. This paper also seeks Cabinet agreement to a further, minor regulatory change to remove the names of those companies from Schedule 3 of the Overseas Investment Regulations 2005 who no longer want to avail themselves of the portfolio investment exemption allowed by the Overseas Investment Act 2005.

### **Executive Summary**

3. In September 2010 Cabinet agreed to make changes to the Overseas Investment Regulations 2005 (the Regulations) and amend the Ministerial Directive Letter to the Overseas Investment Office (OIO) [EGI Min (10) 23/1 refers]. The changes aim to:
  - a. increase Ministerial flexibility to consider a wider range of issues when assessing foreign investments in sensitive land; and
  - b. improve clarity and certainty for investors.
4. To achieve these aims, Cabinet agreed to:
  - a. Introduce two new factors to the benefit test that is used to assess foreign investments in sensitive land: an '*economic interests*' factor that allows for consideration of whether New Zealand's economic interests are adequately promoted by the foreign investment; and a '*mitigating factor*' that allows for consideration of whether the investment provides for New Zealand oversight or involvement in the investment.
  - b. Issue an amended Directive Letter to the OIO. The Letter aims to improve investor certainty by outlining the Government's general attitude towards foreign investment in sensitive assets, and by providing advice to the OIO about which factors in the benefit test are likely to be more or less important for the assessment of particular types of investments.

*New factors to be introduced to the Overseas Investment Regulations 2005*

5. When taking decisions on the changes, Cabinet noted indicative wording of the new regulations and the issues that would be covered in the amended Directive Letter. Drafting is now complete and this paper asks Cabinet to note the final form of the changes.

6. The Act requires factors to be drafted in the positive and be framed as providing additional benefit to New Zealand. I have ensured that the 'economic interests' factor is worded consistent with this (that is, providing benefit to New Zealand over and above the status quo).

7. Wording for the 'mitigating factor' has been tightened up, particularly that relating to New Zealand involvement in the governance and headquartering of the investing entity. This change will assist the OIO to 'look through' business structures to see whether the investment entity has a meaningful commitment to New Zealand involvement.

*Amended Ministerial Directive Letter to the Overseas Investment Office*

8. The Letter has been amended to provide direction to the OIO and guidance to foreign investors on the Government's general policy approach to foreign investment in sensitive assets. I attach the Directive Letter as Annex One for Cabinet's information (paragraphs 4-12 reflect the changes). By way of summary, the Letter outlines:

- a. the Government's general policy approach to foreign investment;
- b. New Zealand's economic context and specific Government concerns about foreign investment in the land-based primary sector; and
- c. factors the Government considers of high relative importance for investments in particular types of sensitive land (particularly the 'economic interests' factor and the 'mitigating factor').

*Additional minor regulatory change*

9. The OIO has also advised of a further, minor regulatory amendment that would be opportune to make at this time. Schedule 3 to the Overseas Investment Regulations 2005 lists portfolio investors (companies) who have applied and been granted an exemption from the consent provisions of the Act. Listed companies pay an annual \$9,712 fee for the exemption. Of the five companies listed on Schedule 3, four have advised that they no longer wish to continue being exempted and so need to be removed from the Schedule. The removal requires a regulatory change, which I propose is introduced with the other regulatory changes noted in this paper.

10. I expect the amendment regulations and the amended Directive Letter to be in place by the end of the year.

**Background**

11. In February 2009 the Government agreed to a regulatory review programme that included a review of the Act and the Overseas Investment Regulations 2005 [CAB Min

(09) 6/5A refers]. The objective of the review was to create an overseas investment screening regime which promotes and encourages the flow of investment into New Zealand while addressing valid concerns about foreign investment.

12. A number of administrative and regulatory improvements were announced in July 2009. In September 2010 Cabinet agreed that two new factors be included in the Regulations and that an amended Ministerial Directive Letter be issued to the OIO outlining the Government's policy on foreign investment more clearly.

#### *Changes to the benefit test for investments in sensitive land*

13. Cabinet agreed that a new 'economic interests' factor and a new 'mitigating factor' be added to the benefit test used to assess investments in sensitive land and noted indicative wording for the new factors [EGI Min (10) 23/1 refers].

14. The 'economic interests factor':

- a. allows Ministers to consider a wider range of economic issues in their assessment of a particular investment, in particular whether New Zealand's economic interests are adequately promoted; and
- b. provides Ministerial flexibility to respond to both current concerns about foreign investment and concerns that may arise in future.

15. The 'mitigating factor' enables Ministers to consider whether the foreign investment provides opportunities for New Zealand oversight or involvement in the investment.

#### *Amendments to the Ministerial Directive Letter*

16. Cabinet also agreed to amend the Directive Letter to the OIO to:

- a. outline the Government's general attitude towards foreign investment in sensitive assets; and
- b. provide advice to the OIO about which factors in the benefit test are likely to be more or less important for particular types of investments.

17. Cabinet agreed that, together, these changes concluded the review of the Act.

#### **The significance of foreign investment to New Zealand**

18. Foreign investment flows are an important source of capital for the New Zealand economy. The stock of foreign direct investment in New Zealand totaled \$92.8 billion for the year ended March 2009, while the annual flow for the same year was \$6.1 billion. As a comparison to give a sense of scale, total Crown Expenses totaled around \$81 billion for the year ended June 2010 while total appropriations for capital expenditure for 2010/11 are forecast to be around \$6.5 billion.

19. Australia is our largest source of foreign direct investment and has invested just under 50% of the total stock of FDI; NZ\$46.1 billion in the year ended March

2009<sup>1</sup>. The tables below show the top five sources of foreign direct investment, both in stock and flow terms.

Stock of Direct Investment in New Zealand (years ended 31 March, \$million)					
Source	2005	2006	2007	2008	2009
Australia	34,273	39,561	44,157	47,370	46,110
United States	9,397	8,727	10,540	10,750	11,469
Netherlands	4,230	3,641	4,303	4,805	4,614
United Kingdom	4,542	4,988	4,075	4,138	3,247
Japan	1,700	1,652	1,819	2,006	3,196
<b>Total</b> (all countries)	<b>72,274</b>	<b>76,977</b>	<b>85,939</b>	<b>88,928</b>	<b>92,817</b>

Flow of Direct Investment in New Zealand (years ended 31 March, \$million)					
Source	2005	2006	2007	2008	2009
Australia	3,913	5,003	4,014	2,384	677
United States	674	-959	1,879	336	1,063
Japan	165	-23	65	141	1,283
Netherlands	386	Not available	692	473	-175
Canada	115	-265	36	437	8
<b>Total</b> (all countries)	<b>3,717<sup>2</sup></b>	<b>2,459</b>	<b>8,843</b>	<b>4,037</b>	<b>6,149</b>

## Comment

20. The drafting of the new factors and amended Directive letter is now complete and this paper asks Cabinet to note their final form.

### *Final form of the 'economic interests' factor*

21. Cabinet noted the following indicative wording for this new factor: *"Whether New Zealand's economic interests will be adequately promoted by the overseas investment"*, where the term 'economic interests' would be defined at a high level in the regulations.

22. The final drafting of the 'economic interests' factor is as follows:

- “(i) whether New Zealand’s economic interests will be adequately promoted by the overseas investment, including, for example, all or any of the following:

<sup>1</sup> Statistics New Zealand, *Global New Zealand – International Trade, Investment and Travel Profile, Year ended December 2009*.

<sup>2</sup> Note that this figure and the 2006 figure are less than the total amount that Australians invested. This was due to *large* negative FDI flows from United Kingdom and Hong Kong which are not listed on this table. These, in combination with the negative flows from the United States and Canada reduced the overall flow of FDI.

- (i) whether New Zealand will become a more reliable supplier of primary products in the future; and
- (ii) whether New Zealand's ability to supply to the global economy a product that forms an important part of New Zealand's export earnings will be less likely to be controlled by a single overseas person or its associates; and
- (iii) whether New Zealand's strategic and security interests will be enhanced; and
- (iv) whether New Zealand's key economic capacity is improved;

23. The main difference between the indicative and final drafting is that the final drafting includes within it an indication of what is meant by 'economic interests'. The drafting uses a list of examples, which is non-exhaustive, to provide a guide to the OIO, decision-making Ministers and investors as to the interpretation of the new factor.

24. The new factor also makes reference to "*whether New Zealand's strategic and security interests will be enhanced*" by the investment. While the wording of 'strategic and security interests' arguably has a broad interpretation, I envisage that this element of the factor will be applied to enable the OIO and decision-making Ministers to consider whether there are non-commercial motivations driving a foreign investment, and to make a judgment on whether the investment thereby promotes New Zealand's economic interests.

25. I have also removed the reference to 'infrastructure' as infrastructure is specifically dealt with by the 'strategic infrastructure assets' factor, which Cabinet agreed to retain.

#### *Final form of the 'mitigating factor'*

26. Cabinet noted the following indicative wording for this new factor: "*Whether the investor proposes to put in place mechanisms for New Zealanders [who are not overseas persons] to participate or have regulatory oversight in the investment, for example by the investor taking any of the following steps:*

- *appointing or retaining one or more director in the relevant entity who is not an overseas person; or*
- *establishing a locally incorporated entity; or*
- *developing the headquarters or head office in New Zealand; or*
- *listing the target on a market operated by New Zealand Exchange Limited or another registered exchange in New Zealand; or*
- *the extent to which New Zealanders [who are not overseas persons] have a partial ownership or controlling stake in the investment, or the extent to which overseas ownership or control is dispersed amongst a number of non-associated overseas persons."*

27. It is important to note that the mitigating factor is one factor that investors can decide to meet in order to demonstrate that their investment meets the benefit test. Investors should not be *required* to put in place any of the mechanisms identified in the

mitigating factor *[Withheld - maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*.

28. The final form of the 'mitigating factor' is as follows:

- “(j) the extent to which persons who are not overseas persons (New Zealanders) will be able to oversee, or participate in, the overseas investment and any relevant overseas person such as, for example, all or any of the following:
- (i) whether there is or will be any requirement that 1 or more New Zealanders must be part of that person’s governing body;
  - (ii) whether that person is or will be incorporated in New Zealand;
  - (iii) whether that person has or will have its head office or principal place of business in New Zealand;
  - (iv) whether that person is or will be a party to a listing agreement with NZX Limited or any other registered exchange that operates a securities market in New Zealand;
  - (v) the extent to which New Zealanders have or will have any partial ownership or controlling stake in the overseas investment or in that person;
  - (vi) the extent to which ownership or control of the overseas investment or of that person is or will be dispersed amongst a number of non-associated overseas persons.”

29. The main difference between the indicative and final drafting is that the final drafting tightens the wording relating to New Zealand involvement in governance and headquartering of the investing entity (particularly parts (i) – (iii) above). There is a risk, which cannot be fully avoided, that entities structure their investment to circumvent the true intent of the regulation. The tighter wording in the final drafting will help the OIO to 'look through' an investment to assess whether the investor has a meaningful commitment to New Zealand involvement.

#### *What the new factors achieve*

30. As I have previously advised Cabinet, it is important to note that the new factors alone cannot be used to decline an investment application. As part of the benefit test, any new factor must be weighed up against the contribution the investment makes to the 19 other factors that form part of the test.

31. However, the table below indicates how the new factors could take account of concerns that have been the subject of recent public discussion, giving effect to the aim for greater Ministerial flexibility:

Concern	How the concern is addressed
Aggregation of farmland by individual foreign investors	<ul style="list-style-type: none"><li>• Could be considered as part of the assessment of whether the investment meets the 'economic interests' factor.</li></ul>

Foreigners, as a group, owning a large portion of New Zealand's farmland	<ul style="list-style-type: none"> <li>• Could be considered as part of the 'mitigating factor' (e.g. by assessing "whether there is or will be any requirement that 1 or more New Zealanders must be part of that person's governing body").</li> </ul>
Lack of transparency of how some investors operate	<ul style="list-style-type: none"> <li>• Could be considered as part of the 'mitigating factor', which allows for a degree of New Zealand oversight of the investing entity.</li> </ul>
Foreign ownership of 'strategic assets'	<ul style="list-style-type: none"> <li>• Could be considered as part of the assessment of whether the investment meets the 'economic interests' factor.</li> </ul>
Foreign government investors with non-commercial motivations	<ul style="list-style-type: none"> <li>• Could be considered as part of the assessment of whether the investment meets the 'economic interests' factor (e.g. by assessing "whether New Zealand's strategic and security interests will be enhanced").</li> <li>• Also addressed if 'mitigating factors' allow for a degree of New Zealand oversight.</li> </ul>
Vertically-integrated foreign-owned firms reducing returns to New Zealand	<ul style="list-style-type: none"> <li>• Could be considered as part of the assessment of whether the investment meets the 'economic interests' factor.</li> <li>• Also addressed if 'mitigating factors' allow for a degree of New Zealand control and oversight.</li> </ul>

### *Amendments to the Ministerial Directive Letter*

32. The Directive Letter has been updated to provide direction to the OIO and the information to foreign investors on the Government's general policy approach to foreign investment in sensitive assets. I attach the amended Directive Letter as Annex One for Cabinet's information and draw Cabinet's attention to the new paragraphs 4-12. By way of summary, the Letter outlines the following points:

- a. *General policy approach.* While the Government acknowledges the purpose of the Act and the consent regime it establishes, the Government wishes to minimise any unnecessary delays or administrative costs in the consent process.
- b. *New Zealand's economic context and specific concerns about foreign investment in this sector.* The agricultural sector forms a particularly important part the New Zealand economy given its contribution to exports and GDP. The Government has identified two specific concerns about overseas investment in the agricultural sector: foreign-owned vertically integrated firms; and the aggregation of agricultural land ownership by overseas investors.
- c. *Factors considered of high relative importance for investments in particular types of sensitive land.* Each application for consent must be considered on a case-by-case basis and assessed against each of the factors for relevance to the application. However, the Government considers that the 'economic interests' factor and the 'mitigating factor' are of high relative importance to the determination of whether overseas investment in farm land will, or is likely to, benefit New Zealand. Under this direction the Government is seeking to address overseas investment in 'large' areas of farm land. Indicatively, an overseas investment would be considered 'large' if it were to result in the ownership or control of an area of land that is more than double the average farm size for the relevant farm type, as defined using Statistics New Zealand data. The Government considers that the aggregation of a number of small parcels contributes towards a large investment and existing acquisitions can be taken into account in determining the extent of aggregation. The Government does not

expect that relatively small parcels of land (e.g. 'lifestyle' blocks) would fall within this direction.

- d. *Application of the 'mitigating factor'.* The 'mitigating factor' is intended to provide investors with opportunity to show how they will allow for New Zealand oversight or involvement with the investment. While investors are not required to put in place such mechanisms, the decision maker will take such mechanisms into account in determining whether this factor is met.

#### *Additional minor regulatory change*

33. The OIO has advised me of a further minor regulatory amendment that would be opportune to make at this time. Schedule 3 to the Regulations lists the names of the portfolio investors (companies) who have applied and been granted an exemption from the consent provisions of the Act. The exemption means that shares held by Schedule 3 companies in subsidiary companies are not included when determining whether a subsidiary company is defined as an "overseas person" for the purposes of the Act.

34. Of the five companies listed on Schedule 3, four<sup>3</sup> have advised that they no longer wish to continue being exempted and so need to be removed from the Schedule. Schedule 3 listed companies pay an annual \$9,712 fee for the exemption. I understand they wish to be removed from the Schedule as they see the benefit of the exemption being outweighed by its costs.

35. The removal of company names from Schedule 3 requires a regulatory change. Providing Cabinet agrees to the change, the Parliamentary Council Office will prepare regulations for introduction alongside the other changes described in this paper.

#### **Consultation**

36. The following organisations have been consulted in the development of this paper: Overseas Investment Office, the Ministry of Foreign Affairs and Trade, and the Ministry of Agriculture and Forestry.

37. The following organisations were informed of the proposals: Department of Prime Minister and Cabinet, Ministry of Conservation, Walking Access Commission, New Zealand Trade and Enterprise, Department of Internal Affairs, Te Puni Kōkiri, Ministry for the Environment, and the Department of Labour. Ministry of Economic Development, and the Ministry of Fisheries.

#### **Financial Implications**

38. There are no financial implications arising from the proposals in this paper.

#### **Legislative Implications**

39. Following direction from Cabinet [EGI Min (10) 23/1 refers], the Parliamentary Counsel Office (PCO) has drafted the regulatory changes to the Overseas Investment Regulations 2005 described in this paper. Subject to Cabinet's direction, PCO will also draft the necessary regulatory amendments to Schedule 3 to the Regulations. I expect

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<sup>3</sup> Asteron Life Limited, Vero Insurance New Zealand Limited, Munich Reinsurance Company and the National Mutual Life Association of Australasia Limited.



the amendment regulations will be considered by the Cabinet Legislation Committee in early December and come into effect in early January 2011. A waiver of the 28 day rule will not be sought.

### **Regulatory Impact Analysis**

40. The Regulatory Impact Analysis (RIA) requirements do not apply to this paper as the proposals contained within it are technical revisions, which fall below the RIA requirements.

### **Other Implications**

41. There are no gender, disability or human rights implications arising from this paper.

### **Publicity**

42. I propose to make public announcements on the new regulations and the new Ministerial Directive Letter when they are approved by Executive Council. The amended Directive Letter will be published on the Overseas Investment Office's website.

### **Recommendations**

43. I recommend that the Committee:

1. **Note** that on 22 September 2010 the Cabinet Economic Growth and Infrastructure Committee, with Power to Act, agreed to conclude the review of the Overseas Investment Act [EGI Min (10) 23/1 refers] by:
  - 1.1 introducing two new factors – an 'economic interests' factor and a 'mitigating factor' – to the benefit test that is used to assess foreign investments in sensitive land; and
  - 1.2 outlining the Government's policy on foreign investment more clearly by amending the Directive Letter issued to the Overseas Investment Office (OIO);
2. **Note** that the Cabinet Economic Growth and Infrastructure Committee considered indicative drafting of the 'economic interests' factor and 'mitigating factor' and that final drafting for these new regulations is now complete, which leave the concepts agreed by Cabinet unchanged.
3. **Note** the final drafting of the 'economic interests' factor:
  - “(i) whether New Zealand's economic interests will be adequately promoted by the overseas investment, including, for example, all or any of the following:
    - (i) whether New Zealand will become a more reliable supplier of primary products in the future; and

- (ii) whether New Zealand's ability to supply to the global economy a product that forms an important part of New Zealand's export earnings will be less likely to be controlled by a single overseas person or its associates; and
- (iii) whether New Zealand's strategic and security interests will be enhanced; and
- (iv) whether New Zealand's key economic capacity is improved;

4. **Note** the final drafting of the 'mitigating factor':

"(j) the extent to which persons who are not overseas persons (New Zealanders) will be able to oversee, or participate in, the overseas investment and any relevant overseas person such as, for example, all or any of the following:

- (i) whether there is or will be any requirement that 1 or more New Zealanders must be part of that person's governing body;
- (ii) whether that person is or will be incorporated in New Zealand;
- (iii) whether that person has or will have its head office or principal place of business in New Zealand;
- (iv) whether that person is or will be a party to a listing agreement with NZX Limited or any other registered exchange that operates a securities market in New Zealand;
- (v) the extent to which New Zealanders have or will have any partial ownership or controlling stake in the overseas investment or in that person;
- (vi) the extent to which ownership or control of the overseas investment or of that person is or will be dispersed amongst a number of non-associated overseas persons."

5. **Note** that the final drafting for amended Ministerial Directive Letter is now complete, which outlines the following:

- 5.1 the Government's general policy approach to foreign investment;
- 5.2 New Zealand's economic context and specific Government concerns about foreign investment in the agricultural sector; and
- 5.3 factors the Government considers of high relative importance for investments in particular types of sensitive land (particularly the 'economic interests' factor and the 'mitigating factor').

6. **Note** that Schedule 3 to the Overseas Investment Regulations 2005 lists the names of the portfolio investors (companies) who have applied and been granted an exemption from the consent provisions of the Act;

7. **Agree** to remove the four companies from Schedule 3 who have confirmed they no longer wish to avail themselves of the exemption (Asteron Life Limited, Vero Insurance New Zealand Limited, Munich Reinsurance Company and the National Mutual Life Association of Australasia Limited);
8. **Invite** the Minister of Finance to issue drafting instructions to the Parliamentary Council Office to give effect to the proposal in recommendation 7;
9. **Note** that the Minister of Finance intends to seek Executive Council approval to the amendment regulations in December so that the changes can come into effect in early January 2011; and
10. **Note** that the Minister of Finance will make public announcements once the regulations and the Ministerial Directive Letter are published in the Gazette.

Hon Bill English  
**Minister of Finance**

Date:

